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Regional Counsel, Midwest Region

Assistant Chief Counsel (Income Tax & Accounting)

Taxability of Quality Award Items

This responds to your memorandum dated August 5, 1991, to the Deputy Chief Counsel regarding the above-referenced matter. Your memorandum states that the Midwest Regional Quality Council currently intends to implement an awards program under which certain employees who contribute to the Quality Improvement Process would be awarded items that range in cost from $3.59 to $22.73. These items will be marked with the Midwest Region's quality logo and will have a market value of less that $35. You have asked for our comments on the tax consequences to employees who receive these awards.

On September 9, 1991, David A. Schneider of our office contacted Richard Witkowski, District Counsel, St. Louis, and informally advised him of our tentative opinion that the quality awards would not be taxable. Our conclusion and reasons therefor are set forth below in greater detail.

Section 61(a) of the Internal Revenue Code provides that except as otherwise provided by the Code, gross income means income from whatever source derived, including compensation for services. Section 61(a)(1) includes fringe benefits in the definition of the term "compensation for services." Accordingly,, any benefit conferred by an employer on an employee that is not specifically excluded under another provision of the Code (such as a fringe benefit specifically excludible under section 132) is includible in the gross income of the employee as compensation under section 61 and must be reported on Form W-2. If an award, however, is a "de minimis fringe benefit" within the meaning of section 132(e), the value of the award is not includible in the employee's gross income or subject to employment taxes, and no reporting is required.

Section 132(e) of the Code defines a de minimis fringe benefit as any property or service the value of which is, after taking into account the frequency with which similar benefits are provided by the employer to its employees, so small as to make accounting for it unreasonable or administratively impracticable.

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Section 1.132-6(e) of the Income Tax Regulations provides examples of de minimis fringe benefits, including: occasional cocktail parties, group meals, or picnics for employees and their guests; traditional birthday or holiday gifts of property (other than cash) with a low fair market value; occasional theatre or sporting event tickets; coffee, doughnuts, and soft drinks; local telephone calls; and flowers, fruit, books, or similar property provided to employees under special circumstances.

The two factors set forth in section 132(e) of the Code, small value and frequency, are interrelated, and both must be considered to determine whether a benefit is de minimis. However, if the fair market value of a fringe benefit is so high that the benefit is clearly not de minimis, then the frequency with which the benefit is provided is not relevant. Alternatively, a benefit of minimal value may be provided so frequently that the benefit is, in effect, part of the employee's compensation and is not considered de minimis.

An additional relevant factor to consider when determining whether an employee award is de minimis is the following language from the General Explanation of the Tax Reform Act of 1986 included in the discussion of amendments made to sections 74 and 274 of the Code, which govern certain employee awards:

> Congress believed that no serious potential for avoiding taxation on compensation arises from transfers by employers to employees of items of minimal value. Therefore, the Congress wished to clarify that the section 132(e) exclusion for de minimis fringe benefits can apply to employee awards of <u>low value</u>. (Emphasis added).

Joint Committee on Taxation, 99th Cong., General Explanation of the Tax Reform Act of 1986, 33 (Comm. Print 1987).

Generally, a quality award with a fair market value not in excess of $35 would qualify as a de minimis fringe benefit. It would be considered a de minimis benefit similar to flowers, fruit, or books provided to an employee on account of outstanding performance. When the fair market value of a quality award exceeds $50, additional scrutiny of the facts and circumstances would be required to determine whether that award would be de minimis. However, a quality award with a fair market value of $100 or more would not be considered de minimis.

Finally, you also asked whether the $35 de minimis exception to the requirements for reporting receipt of gifts in the public financial disclosure regulations at 5 C.F.R. §734.301(c)(5),

redesignated as 5 C.F.R. §26534.301(c)(5) may be used to define a de minimis fringe benefit under section 132 of the Code. As the foregoing analysis demonstrates, sufficient guidance exists under the Code to determine whether the quality award is a de minimis fringe benefit. It is not appropriate to rely on the public financial disclosure regulations to determine whether a quality award is a de minimis fringe benefit.

We hope that this information adequately responds to your request. If we can be or any further assistance in this matter, please contact David A. Schneider at (202) 566-6438.

(signed) Robert A. Berkovsky

By: _____
Robert A. Berkovsky
Chief, Branch 2